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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 001193

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DEPT FOR EB AND EUR

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TAGS: ENRG EPET ECON PREL PINR RU GG AJ
SUBJECT: BP AND STATOIL UPDATE EUR DAS BRYZA ON CASPIAN GAS

Classified By: Charge d'Affaires Jason P. Hyland, per 1.4 (b,d).

¶1. (C) In an August 1 meeting, executives from BP and Statoil briefed EUR DAS Bryza on current prospects for increasing Caspian gas exports to European markets. BP and Statoil reported that delays in completion of the Turkish segment of the South Caucasus Pipeline (SCP) will force diversion of initial Shah Deniz phase I production solely to Azerbaijani and Georgian domestic needs, at least through the end of October. They said that negotiations for sale of Shah Deniz phase II volumes to Europe will depend on Turkey's role as a transit country, Azerbaijan's still unknown plans to divert some portion of the phase II volumes for domestic consumption, and ongoing Azerbaijani-Russian negotiations over Gazprom sales to Azerbaijan for 2006-2007. Russia, they said, does not want to see Azerbaijan sell gas to Turkey below Blue Stream prices. Prospects for Azerbaijani gas sales to Europe are further complicated by what the executives characterized as a complete lack of strategic planning capacity within SOCAR. Until Azerbaijan determines its own long-term domestic gas needs, BP and Statoil said they will not be able to make a commercially viable proposal for gas sales to Europe. For this reason, Azerbaijan could not be expected to make more than a symbolic gas sale to Greece before the end of the year. BP said USG political support will be necessary to resolve the Turkish transit issue. End summary.

¶2. (C) The Ambassador and visiting EUR DAS Bryza met with BP/Azerbaijan President David Woodward and Statoil/Azerbaijan VP for Gas Jan Heiberg on August 1 to review current prospects for increasing Caspian gas exports to European markets. Confirming that delivery of first gas from the Shah Deniz field was on track for early September, Woodward said that delays in completion of the Turkish segment of the South Caucasus gas pipeline would require diversion of Shah Deniz gas for domestic consumption in Azerbaijan and Georgia at least through the end of October. Woodward speculated that the delay could drag into 2007. Woodward said that SOCAR was completing the upgrades to Azerbaijan's gas infrastructure necessary to handle the in-fill from Shah Deniz (a short connection from the Sangachal terminal to Azerbaijan's gas network), which should be ready by September 1. Woodward said that the excess gas -- which cannot be sold to Turkey until the Turkish segment of SCP is completed -- could easily be absorbed by Azerbaijan and Georgia's domestic markets.
(In a separate July 28 meeting with Charge, Woodward said

that Azerbaijan could supply up to twenty percent of Georgia's gas needs this winter.) Woodward added that Azerbaijan's current gas network has a maximum capacity of four bcma. (Once the Turkish segment of SCP is fully operational, just 1.5 bcma of Shah Deniz phase I production will go to Azerbaijan's domestic market.)

¶3. (C) Woodward said that Azerbaijan and Georgia currently are negotiating the exact amount of excess SCP gas that will be sold to Georgia until the Turkish segment of SCP is complete. He said that a basic agreement to sell the gas to Georgia had been reached on the margins of the BTC celebrations in Istanbul, but the two sides are still haggling over quantity and price. Azerbaijan and Georgia are expected to reach an agreement before August 15. Woodward noted that the Georgian offtake for SCP is under construction and should be completed by late September.

¶4. (C) Separately, Azerbaijan and Russia are negotiating the terms of Gazprom gas sales to Azerbaijan for 2006-2007. (Azerbaijan currently relies on Gazprom for roughly 50 percent of its natural gas needs.) Woodward said that Russia is threatening to cut off all gas exports to Azerbaijan if Azerbaijan exports any new gas volumes of its own to Turkey. Russia, Woodward said, is extremely worried that Azerbaijan will sell gas to Turkey below Blue Stream prices. For this reason, Azerbaijan wants to wait to move forward on any new gas deals with Turkey until the Gazprom negotiations are finished. Bryza commented that anything more than a symbolic shipment of Azerbaijani gas to Greece would be very difficult to achieve before the end of the year.

¶5. (C) Both Woodward and Heiberg questioned the role Turkey would play in the export of Shah Deniz phase II volumes to

Europe, noting that Turkey appears to want to sell gas at a profit rather than simply serve as a transit country. Bryza said that the U.S. shares this concern and relayed his own conversations with Turkish Foreign Minister Gul and Energy Minister Guler to ensure they understand that any arrangements for the transit of Caspian gas through Turkey must be commercially viable. Future sales of Caspian gas to Greece, Bryza noted, will depend on the Turkish transit arrangements. Heiberg agreed, and said that Statoil is working on a concrete business proposal, along the lines of the Nabucco agreement, that could be presented to Turkey.

¶6. (C) Prospects for Caspian gas exports to Europe are further complicated by the current indecision within Azerbaijan over how best to utilize volumes from full-field Shah Deniz development, both Woodward and Heiberg said. Azerbaijan has not yet decided how much of the phase II volumes will be kept for domestic consumption. Woodward said he is hearing signals that some within Azerbaijan's leadership want to take all of the gas for domestic consumption. Until Azerbaijan decides how much of the Shah Deniz phase II volumes are diverted for domestic consumption, Woodward said the international companies cannot plan exports, particularly as the companies' share of production will change over time under the Production-Sharing Agreements (PSA). The PSA issue could be solved by a decision to merge volumes for export, as had been undertaken for Shah Deniz phase I production, but Woodward said a quick decision on this strategic decision is unlikely. Bryza explained that President Aliyev had noted during and since his Washington visit that Azerbaijan's priority was now to accelerate Shah Deniz Phase II production to seize market share in Greece and Italy, before Gazprom beat Azerbaijan to those and other European markets by expanding the Blue Stream pipeline to Turkey. Woodward and Heiberg welcomed the news but lamented that SOCAR and the Ministry of Energy were not yet acting to implement this decision.

¶7. (C) Woodward and Heiberg both complained that SOCAR's ability to undertake strategic planning was severely hampered

by the December 2005 appointment of Rovnaq Abdullayev as the company's new President. Of the current SOCAR leadership, only VP Elshad Nasirov has the capacity to undertake strategic analysis and planning and Nasirov, according to Woodward, had been tapped to lead all of SOCAR's ongoing negotiations. Woodward and Heiberg said that all of their business with SOCAR grinds to a halt when Nasirov is otherwise occupied, as he currently is with negotiations with both Georgia and Russia. Heiberg commented that SOCAR has no capacity to determine Azerbaijan's long-term energy consumption needs and hence its long-term export capacity. Statoil is trying to help move the process along by preparing a White Paper that will provide both a historical review of Azerbaijan's energy development and a prospective look at all of Azerbaijan's gas reserves. Woodward and Heiberg agreed that capacity-building is desperately needed at all levels of SOCAR, and commented that Azerbaijan's top leadership (e.g., President Aliyev) does not understand the depth of the problem.

¶8. (C) In order to help secure access for Azerbaijani gas to European markets, Woodward said that the U.S. could help by building capacity at all levels in SOCAR and particularly in the area of strategic planning. Politically, Woodward said that USG help is needed to get further clarity and transparency on Turkey's role in the transit of Caspian gas to European markets. Bryza assured Woodward and Heiberg that the USG was committed to helping bring Caspian gas to European markets. He also said that the US may be able to consider sending someone to discuss capacity-building with SOCAR.

¶9. (U) EUR DAS Bryza cleared this message.
HYLAND